LIFE INSURANCE INVESTMENTS

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In discussing the subject of life insurance investments the following topics will be briefly considered:

First.—How life companies differ from other investors, such as individuals, trust companies or banks.

Second.—Requirements of the statutes of the different states.

Third.—Investments regarded as most suitable for life insurance companies.

Fourth.—Management of investments, by whom placed and the precautions taken.

Fifth.—The extent of life insurance investments.

Sixth.—Taxation of the assets.

How Life Companies Differ from Other Investors.

The individual investor, unless acting as trustee, is under no restriction, and is governed merely by the dictates of his own sweet will. For our purpose, therefore, we need not discuss the individual investor.

Aside from the detail of circulation, with which every one is more or less familiar, a national bank devotes its attention chiefly to the reception of deposits from business firms and others, and the lending of money to them. It is also a buyer of commercial paper. Moreover, the bank which credits your account with cash deposited at three o'clock to-day must, if required, prepare to meet your check to-morrow. It must, therefore, keep in actual money a sufficient proportion of its resources to supply these daily needs. Further-

more, as deposits are drawn upon in times of monetary pressure, a large part of its assets must be of that kind which can be quickly converted into cash, such for instance as government, state, municipal and standard railroad bonds.

The trust company acts as trustee, executor, administrator, guardian, attorney, etc.; its much advertised advantages over an individual in these capacities being that the trust company does not die, presumably has no bad habits and is customarily more responsible than is the individual.

Trust companies also take money on deposit. They do not issue bank notes, and, generally speaking, are not dealers in commercial paper, their loans being almost always protected by pledge of collateral security. Some of them, for instance those of Massachusetts, like the savings fund societies, are restricted as to the investments they may purchase. This is not the case in Pennsylvania. Many of their trusts are distributable in kind; others become payable at fixed dates in the distant future, thus affording ample time to prepare for settlement. Trust companies consequently become buyers of real estate mortgages, municipal and corporation bonds, bearing a fair rate of interest, and which, while good, do not, for their purpose, need to be instantly marketable.

With respect to life insurance companies, the most progressive ones issue insurance contracts promising loans, or cash surrender values upon demand of the insured. To fortify themselves against this feature of the business—against these obligations maturing on demand—the companies which issue them carry a safe proportion of their fund in collateral loans and other investments which are readily exchangeable for cash.

Aside from these demand obligations, the chief life insurance liability is for the payment of maturing endowments and of death losses. Of the maturity of an endowment policy, the company has from ten to twenty or more years' notice. Death losses, on the average, occur so closely in accordance with the yearly estimates, so safely within what are technically known as the "tables of mortality," that life insurance investments do not need to be so quickly salable for cash, as is the case with those of most financial institutions. Life insurance companies are not closely restricted in the territory to which they must confine investments. They may purchase almost anything which could be lawfully owned by a bank,

a trust company or a savings society, except that they do not buy commercial paper, lend upon personal credit or advance money without collateral security. For this reason, one never finds the name of a life insurance company upon a list of unsecured creditors.

The banker must keep within easy reach a fair amount of money for emergencies. Throwing out the cash surrender and policy loan items, the life insurance official, on the contrary, has no emergencies to meet. The daily claims against him are so accurately foretold that he has no need for a large cash balance, but rather makes it his duty to keep this item at the lowest point consistent with convenience; thus idle and unproductive balances by most companies are avoided. We will now consider the second specification:

Requirements of the Statutes of the Different States.

Most of the larger companies—those companies which have stood the test of time, and which have asset accumulations of importance—were established long before life insurance had become generally understood. Their charters were framed before knowledge was acquired respecting many features of the business later found essential, and were in some instances so framed as inconveniently to limit the company's selection of investments. In many cases where they have been found cumbersome, these old charters have been amended to conform to modern needs, and the companies have thereby gained larger liberty of investment purchase.

Generally speaking, it may be said, as already intimated, that there is no important statutory restriction upon the subject of purchasing securities. The various companies, however, transact the business of life insurance in almost all the states, and the states in turn have departments of insurance—for the most part under trained insurance men, authorized to revoke the license in that state of any company not able to respond to the strictest test of solvency. There is a large discretion vested in each state insurance commissioner as to what asset shall and what shall not be accepted at its face. This undefined and to some extent uncertain standard of personal judgment—this vague, unmeasured, discretionary power of rejection—perhaps more than any statutory requirement could do, causes

the life insurance management to be extremely critical as to what form of security shall and what shall not appear upon its list.

There is now much talk of federal instead of state supervision over life insurance. The United States Supreme Court decisions so far have not been broad enough to include life insurance within the legal definition of what is known as "interstate commerce." Until this court assigns a wider meaning to that term, the proposed federal supervision is not likely to occur.

We now come to the third and fourth topics of our inquiry, namely:

Investments Regarded as Most Suitable for Life Insurance Companies,

and

Management of Investments, by Whom Placed and the Precautions Taken.

The executive staff of a large life company is usually composed of men whose energy is not expended upon the lesser details of corporate management. It seems to be their aim, however, to have each department conducted by some one who is a specialist in that particular line. This specialist in turn must have trained and efficient men under him, not only to assist, but to act as "understudies"— so to speak—men who are qualified to assume any responsibility which may devolve upon them, so that the absence or inability of any one man shall not stop the wheels of business. The financial man, for instance, is not expected to have specific knowledge of the agency, the mathematical or the medical department, each of which is conducted by some one who has, perhaps, devoted his life to the study of his own particular specialty.

With respect to the selection and purchase of investments it may be said that in addition to real estate mortgages, which are among the most important, and will be treated later, investments regarded as most suitable for life insurance companies, appear to stand as to safety in about the following order, namely:

Government, state and municipal bonds.

Standard railroad bonds.

Equipment or car trust bonds.

Bonds of electric railways of developed earning capacity.

Bonds upon public utility enterprises.

Bonds of industrial corporations, and

Stocks of corporations.

Real estate will be considered later on.

There are objections to each class, and it is the duty of the officer who buys to be so familiar with each objection that it may be given full weight during consideration of a purchase.

The first four named—government and state bonds, and municipal and standard railroad bonds of highest grade—produce an interest return so low that the margin, if any, is quite small over the interest required upon the company's reserve. This is the objection to investments of the highest quality, yet all good companies buy them, in order to supply a large proportion of what are known as "quick assets"—assets which can be converted into cash with least delay and with least danger of loss through serious depreciation.

Equipment or Car Trust Bonds.—Rent for the use of rolling stock is now considered one of the first charges upon the earnings of a railroad company. Equipment bonds, therefore, issued by strong railway corporations and secured by trust deed upon rolling stock, are at present a favored form of investment, but are open to the objection that they do not furnish a sufficiently permanent occupation for the fund. Equipment or car trust bonds are issued by the railway companies, for from 70 to 90 per cent. of the equipment's cost, and provide for annual payments of 10 per cent. or more, in reduction of the principal debt, which payments will retire the equipment bonds in from one to ten years, and class them as temporary investments.

It is made the duty of the trustee, through which these car trust bonds are issued, to see that the cars are kept in good repair, that new ones are purchased, marked and numbered, in place of those destroyed by fire or accident, and that an ample amount of fire insurance is always kept in force. The vital point, to insure the safety of an investment in car trust bonds, is the trustee's rigid enforcement of these conditions. Banking houses which are most successful in creating a market for car trust bonds are, or should be, those which are most noted for the care which they require to be taken by the trustee in the carrying out of the letter and the spirit of the contract. As is known, there is now pending a political agitation

upon the subject of railroad rebates in return for the use of private freight cars owned by large shippers. This inclines investors to disapprove car trusts not issued by the railway companies themselves.

Bonds of Electric Railways.—Bonds upon non-competitive street railways located in densely populated and rapidly growing cities are looked upon with favor, provided the net earnings are satisfactory and the railway company's franchise is not defective.

Bonds upon suburban and interurban electric railways are rarely purchased by the life companies until the properties have been constructed a sufficient length of time to demonstrate an earning capacity ample to pay operating expenses, interest and a considerable surplus, the objectionable feature in connection with this form of security being that the depreciation of the plant of an electric railway is thought—by some persons well informed—to represent a sum of money almost equal to the average interest upon its debt. If this be true, it is obvious that the electric railway company's bond should rest upon a property producing net earnings of approximately double the interest charge.

Bonds Upon Public Utility Enterprises, such as gas, water, electric light and power companies, are not specially attractive to the life insurance company. They depend so much upon legislative franchise, and are so open to attack through this channel, and through misunderstandings with municipalities involved, that life insurance managers look upon them with favor only after the most exhaustive investigation.

For instance, it may be said of water works plants that though water is an absolute necessity, and the plants furnishing it have therefore been thought sound as a basis for investment, yet water plants—erected and operated as private enterprises—have been a most fruitful source of litigation, and of resulting loss to bondholders.

Bonds of Industrial Corporations are rarely purchased by the most conservative companies. They are so dependent upon that personal feature which stands for good management and so affected by industrial depressions that, with few exceptions, they are disapproved.

Stocks of Corporations.—The advertising pages of the current magazines reveal an emphatic statement by one well-known company that it is now the owner of no corporation stocks of any description.

From this we may safely conclude that, for the present, stocks are not being largely purchased by the conservative life insurance companies, though some of the companies have greatly profited by the rise in value of their stocks in banks and trust companies.

Real Estate.—Real estate is hardly considered an investment by the life insurance company, except as incidental to the property's other uses. Many companies own office buildings in different parts of the country. In addition to furnishing space for the conduct of the business, some of these buildings produce an adequate net interest return—many of them do not—but they all serve the original advertising purpose of keeping the company before the public eye.

Real estate, other than these office buildings thus voluntarily acquired, usually consists of those properties purchased, perforce, under foreclosure of real estate mortgages, and reflects good or bad management, as the case may be—in the company's mortgage department, ownership of a very small percentage of foreclosed real estate being considered an evidence of good management.

First Mortgages Upon Real Estate Security.—This line of security which, as yet, I have scarcely mentioned is one of the most important of all. It is this portion of the investment business which, well managed, will produce the largest interest return commensurate with safety; which, properly conducted, imposes upon the investor the smallest ratio of loss, but which, nevertheless, requires for success the closest attention to a great multitude of details.

In the purchase of real estate mortgages, the company avoids those which rest upon speculative ventures, or even upon good property if it be of a kind which depends too much upon personal management; and if an exception be made in favor of such a property, it is generally because there is offered an unusually large margin of value as an offset to this risk.

In large cities where real estate is quickly salable and values are well established, the investors lend as high as 60 to 80 per cent. of the property's value. Here undue competition among investors reduces rates—makes the interest return too low—and increases loss by reason of a diminished margin, *i. e.*, in the large cities, where money is most plentiful and most urgently seeking investment, it sometimes very improperly becomes a question as to which investor shall lend upon a given property, at the lowest rate, the largest sum

of money. Most of the life companies wisely avoid this dangerous form of competition. It may be here remarked, however, that the money lenders appear to be almost the only capitalists who have not yet developed the good sense to consult or combine for the sake of safety and a satisfactory interest return.

Outside of large cities, governed by the special circumstances of each particular case, the mortgage will represent from 35 to 60 per cent. of the property's supposed market value.

The personal element should enter largely into consideration of a mortgage or any other loan. The investor naturally prefers to lend to the successful man, because the successful man is able to repay the debt. Perhaps this feature may be best expressed by giving a financial man's jocular answer to a friend applying for a loan upon collateral security. He said to his friend: "If you really must have this money, I will not lend it; but if you can thoroughly convince me that you do not need it, I will let you have it with great pleasure."

Life insurance corporations, as a rule, carry in real estate mortgages—first mortgages—from 20 to 50 per cent. of their entire assets—few of the important companies own less than 20 per cent., and a few—western companies chiefly—carry more than 50 per cent., the aggregate real estate mortgages on January 1, 1904, being five hundred and seventy-three millions of dollars ($573,262,009), about 27 per cent. of the total assets.

The well-managed life insurance corporation, investing largely in mortgages, keeps in its employ, in addition to an office force, a sufficient number of men of the highest order of ability, whose duty it is to examine and pass upon the merits of properties offered as security for mortgage; to frequently inspect properties covered by mortgages already owned; to report promptly any change of values due to a change of business centers, or to neglect of improvements and repairs or to other causes. A competent office force is needed for the prompt collection of interest; to watch carefully that sound fire insurance is furnished and renewed before the date of expiration; to ascertain that the property has not been sold for non-payment of taxes, but, on the contrary, that taxes and assessments for paving and other improvements are promptly paid on or before the final date fixed by statute. This requires some knowledge of the varying tax laws of many different states.

In short, while the taking of real estate mortgages entails a great degree of caution, a large amount of labor and an office force of high efficiency, yet the very fact that the small investor cannot afford the expense of these numerous precautions makes it possible for the life insurance corporation to collect an acceptable interest return through holding a large proportion of its assets in safe mortgages upon real estate security, and, at the same time, to avoid those annoying fluctuations in market value which are inseparable from investments placed in other channels. The fact that mortgages are not "quick assets" is the chief reason for not carrying a much larger proportion in this description of security.

Precautions Taken in Purchase of Securities.

One of the most important is to buy from long-established firms of highest standing—men who have the ability, the means and the facilities to ascertain the facts, and the candor and integrity to report them. Aside from this, during years of experience and observation, the studious financial man endeavors gradually to absorb a general knowledge of the affairs of borrowing corporations, and especially a familiarity with the surest way to find the facts.

With most railroad and corporation bonds, the cost or value of the property as compared with its bonded debt is one of the most essential points and one of the most difficult to ascertain. Hardly second to this are the items of gross earnings and of expenses of management and operation and consequent net earnings applicable to interest payments. Perhaps one of the most suspicious items is an abnormally small expense ratio, while the construction account remains still open and during the time that bonds are being offered on the market. What is industriously searched for and rarely found, at a fair price, is a bond representing but a small proportion of the cost of a property which, though admitting an ample expense account, is still able to produce earnings sufficient to pay expenses, interest and a large surplus for the stock.

Time does not permit a recital of all the precautions taken to see to the legalities with respect to investments purchased. Perhaps it may suffice to say that there is employed a force of trained lawyers whose duty it is to assume in each case the labor and responsibility of a thorough investigation, in order to prove each mort-

gage to be a first incumbrance upon a good and marketable title, and each bond a valid, binding and lawfully issued obligation. This is the conclusion which must be reached in every case before paying out the money. We now come to the fifth specification.

The Extent of Life Insurance Investments.

I am indebted for my insurance facts to the "Compendium of Official Life Insurance Reports" for the two years ending January 1, 1904. This was the publication at hand, and later data would have only changed the figures without altering their relative importance. To bring these figures up to date would add about 10 per cent. to the totals I shall use.

There are ninety-two companies mentioned—of various grades—seventy-nine of them having admitted assets of $2,055,555,548 (in speaking, I will disregard odd figures as confusing), admitted assets then of two billions; assets not admitted, seven millions ($7,-110, 701).

At this point it may be well to say that the two billions of assets are invested in approximately the following proportions:

	PER CENT.		PER CENT.
Bonds	40	Cash	4¾
Mortgages	27	Collateral loans	3
Real Estate	8	Other investments	3
Stocks	7¼		
Premium notes, etc.	7		100

This is the division of the total. The individual companies hold different proportions.

It is stated that American farm products reached, in 1904, the huge total of $4,900,000,000, nearly five billions of dollars. These farm products are the output of a territory extending from the Atlantic to the Pacific—the result of the labor of millions of men. The life insurance accumulations aggregate more than 40 per cent. of this vast total. Here we find a striking illustration of the greatness of this fund.

In order that we may form some conception of this great sum of two billions of admitted assets, let me say that, equally divided, it would represent over $25 for each man, woman and child in this

country; it is nearly three times the combined capital of the 5,134 national banks; it is two-thirds of the total of savings bank deposits; it greatly exceeds the amount of our national debt; it is nearly double the value of the year's product of all minerals in this country; it is nearly 50 per cent. in excess of the gross receipts of all the railroads; it is more than the entire world's production of gold for the last six years.

It will show the relative importance of the companies if attention is directed to the fact that 99 per cent. of this great fund is controlled by thirty-one companies, and 1 per cent. only by the other sixty companies.

As permanence and solvency are the essentials of success in life insurance, this concentration ought not to be hastily condemned as altogether undesirable. The possession of 99 per cent. of the insurance wealth should surely furnish means to attract the higher grade of talent to the companies thus strongly fortified.

The detailed information regarding their affairs, furnished by the life insurance corporations, and the publicity given this detailed information, are greater than any other industry affords. The supervision over this industry, exercised by the various state insurance departments is—as it should be—more rigid than that exercised over any financial, commercial or transportation interest. This publicity, this rigid supervision, this veto power over the action of the management, ought to be sufficient protection to the public against any now existing evils of this concentration, and yet the control of $1,235,000,000—60 per cent.—of this fund by four companies is placing upon a very few men a grave responsibility and presenting to them a serious problem of the future.

To firmly fix in mind the distribution of this insurance wealth, let me recapitulate. The total on January 1, 1904, was in round numbers $2,055,000,000—60 per cent. held by the four large companies, 39 per cent. by twenty-seven companies of more moderate size, and only 1 per cent. by the remaining sixty small concerns.

To attempt to express sentiment in terms of money seems questionable taste, but these enormous assets appear to lose their mercenary character when we reflect that they are gathered together to perpetuate the American home; that they are a product of the thrift, the energy, the self-denial of the American bread winner; that they stand in token of his sturdy, sterling character while liv-

ing, and become an almost sacred tribute to his memory, after he has gone.

Taxation.

This vast accumulation has been found wonderfully attractive to the tax gatherer. Those of us who are connected with purely mutual companies—companies which have no capital stock and which are not organized for profit—are at a loss to understand why these mutual companies should be so largely taxed.

The mutual company is composed of individuals, each of whom, in connection with other interests, may be presumed to pay his full share of national, state, municipal and other taxes.

I do not say there is, but there may be, some reasonable defense of a moderate tax upon the small speculative portion of a tontine policy's accumulations, but there is none for taxing the great bulk of a mutual company's assets, held for the protection of its insurance contracts.

Under an intelligent system of taxation, the tax is placed upon the profit: you do not tax a loss. In the purely mutual company, there's no such word as profit; the company performs its function with no such object; insurance is furnished at its actual cost.

The theory which underlies the formation of a purely mutual life insurance company, is that it is simply a means, for the equal distribution of an inevitable loss. Let us suppose a combination of ten, one hundred or one hundred thousand men—the number has no significance except to produce an average—let us suppose each of these men agrees to pay a certain sum for the relief of the families of those who die—to restore to each family that of which it has been deprived, the insurable value of its departed head. Elaborate it, complicate it with varied forms of policies, safeguard it with actuarial tables as you will, and still the basic fact remains, beyond dispute, that each member of a mutual company, by payment of his premium, merely contributes that sum which represents his share of loss. Taxation of this, is so much added to the loss, or so much subtracted from the insurance benefit. It is difficult to understand the justice, the wisdom or even the expediency of putting a tax upon a loss and thus adding to its burden.

Whatever the original intent, the ultimate result of the formation of a mutual company is to prevent the families of its members from becoming a charge upon the public. Every dollar of tax upon a mutual company, therefore, antagonizes public welfare, in so far as it tends toward the defeat of this beneficent result.